Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	**WC Docket No. 03-225**
Request to Update Default Compensation Rate For Dial-Around Calls from Payphones	)	**RM No. 10568**

COMMENTS OF SPRINT CORPORATION

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The Commission has issued a notice of proposed rulemaking[1] inviting comments on its tentative conclusion that it should revisit the default payphone compensation rate imposed by the Commission's rules, based on its current "marginal payphone" methodology. Sprint respectfully makes this submission on behalf of its business units that include both a substantial payer of payphone compensation and a recipient of such compensation for tens of thousands of payphones nationwide.

I. INTRODUCTION AND SUMMARY

The NPRM follows petitions filed by the American Public Communications Council ("APCC")[2] and the RBOC Coalition[3] (together, "Petitioners") seeking a doubling of the current, Commission-dictated per-call compensation that payphone

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1 *Order and Notice of Proposed Rulemaking*, FCC 03-265 (rel. Oct. 31, 2003) ("NPRM"). A corresponding notice appeared in the Federal Register on December 8, 2003. 68 Fed. Reg. 68312.

2 Request That the Commission Issue a Notice of Proposed Rulemaking (or in the Alternative, Petition for Rulemaking) to Update Dial-Around Compensation Rate (filed Aug. 29, 2002; corrected copy filed Aug. 30, 2002).

3 Petition for Rulemaking (filed Sept. 4, 2002). The RBOC Coalition described itself as consisting of BellSouth Public Communications, Inc., SBC Communications, Inc. and the Verizon telephone companies.

service providers ("PSPs") receive from interexchange carriers, and some local exchange carriers, for access code and subscriber 8XX calls made from payphones.[4] The petitions also sought "modifications" to the current methodology to load in additional cost elements to help justify their proposed increase. RBOC Coalition at 2; see also APCC at 2. The Petitioners seek to increase the current rate from 24 cents per call to at least 49 or 48.5 cents per call, respectively.

Sprint joined a dozen other parties, all opposing the Petitioners.[5] Indeed, every commenter agreed that the petitions were unjustified, that their cost studies were flawed, misleading, and based on improper assumptions, and that their requests for rulemaking were manifestly contrary to the public interest. The commenters uniformly agreed with Sprint that entertaining petitions to increase the payphone compensation rate would do nothing to meet the goals Congress set in 1996 in section 276 of the Act (47 U.S.C. § 276(b)), and would in fact only accelerate the decline of the payphone industry.

Sprint was among many parties explaining that the Commission's current methodology is flawed and encouraging the Commission to rethink its approach to payphone compensation. Commenters reiterated the long-overdue need for the Commission to reassess both its overall regulatory policy regarding the proper means to

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[4] The current rate was adopted in the *Third Report and Order*. Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, *Third Report and Order, and Order on Reconsideration of the Second Report and Order*, 14 FCC Rcd 2545 (1999) (subsequent history omitted).

[5] Comments and reply comments were filed on October 29 and November 14, 2002, respectively, in response to a Commission public notice (DA-02-2381), released September 30, 2002. An additional commenter filed a letter in opposition on October 7, 2002. Filers included IXCs and resellers, a wireless messaging carrier, two organizations representing telecommunications users, a domestic violence prevention organization, a private individual, and the Texas Attorney General. In addition, the International Prepaid Communications Association filed comments in the present docket on December 2, 2003.

meet the public interest and goals underlying section 276, in light of changed market conditions and the lessons learned from experience with the current system. This includes assessing whether the public interest and Congressional goals are well-served by the current default compensation regime, whether the current rate-setting methodology should be reexamined, and whether other policy alternatives offer greater efficiencies and public interest benefits. Sprint and WorldCom explained that the Commission should abandon its current carrier-pays payphone compensation scheme for the efficiencies and market rationality of a caller pays system.[6] In fact, the industry trends that the Petitioners claim justify an increase in rates instead make the adoption of a caller pays system all the more compelling.

II. THE COMMISSION SHOULD DECLINE TO INCREASE THE PAYPHONE COMPENSATION RATE.

A. An increased payphone compensate rate is unwarranted and contrary to the public interest and the stated goals of Congress.

The NPRM asks whether a change in rate is warranted, and what the amount of any rate change should be. NPRM ¶ 25. Sprint believes no increase is justified. Surely the cost studies provided by APCC and the RBOC Coalition do not justify an increase, as Sprint details in Section III(A) below. The Petitioners have not shown that a "marginal payphone" (as defined by the *Third Report and Order*[7]) needs a higher rate to cover its costs. Instead, they have shown only that *unprofitable payphones* could be made to cover

[6] Sprint at 5-8 & Att.; WorldCom Reply at 5-6.

[7] *Third Report and Order* ¶ 15 n20.

their costs by doubling the current compensation rate. But even that would require adding in costs that the Commission has previously disallowed.

PSPs are not the only members of the communications industry facing changing market conditions and declining revenues. Nationwide, interLATA long distance revenues declined from $110 billion in 2000 to $99 billion in 2001,[8] and that decline doubtless continued in 2002 and 2003.[9] Moreover, the major independent IXCs are losing market share. The collective residential interLATA market share, by minutes, of the largest independent IXCs, for example, fell from 80.7% in 1999 to 58.3% in 2002 – with most of the decline attributable to gains by RBOCs, whose affiliates own the vast majority of the nation's payphones.[10]

Because of those competitive pressures, any increase in the payphone compensation rate can lead only to higher rates for consumers, higher rates for subscriber 8XX customers, and higher costs for reseller carriers. Already, the *cost* of payphone compensation, even without administrative expenses, can exceed an IXC's *revenue* for many long distance call, excluding payphone surcharges. Thanks mainly to long distance competition, IXCs' per-minute calling rates have been falling for years. In 2001, the average revenue per minute for domestic interstate calls was only $0.08 – down from

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[8] Industry Analysis & Technology Division, Wireline Competition Bureau, Statistics of the Long Distance Telecommunications Industry (rel. May 14, 2003) at 3 & Table 2 ("LD Statistics").

[9] The latest Commission data on long distance revenues shows that the combined toll service revenues of AT&T, MCI/WorldCom, and Sprint declined 9.3% between 2000 and 2001 (from $70 to $64 billion), and 17.9% between 2001 and 2002 (from $64 to $52 billion). Industry Analysis & Technology Division, Wireline Competition Bureau, Trends in Telephone Service (rel. Aug. 7, 2003) at Table 9.1.

[10] LD Statistics at 4.

$0.12 in 1996.[11] IXCs have already found it necessary to increase their rates for payphone calling to secure additional revenue and cover costs.

The NPRM includes relatively little discussion of the public interest; the term "public interest" does not appear in its text. Nevertheless, the Commission appreciates, if the Petitioners do not, that the stated goals of Congress are "to *promote competition among payphone service providers* and promote the widespread deployment of payphone services *to the benefit of the general* public." NPRM ¶ 3, quoting 47 U.S.C. § 276(b)(1) (emphasis added). The Commission's public interest analysis cannot properly disregard the fact that the general public does not need or want the number of payphones that are currently deployed.

A compensation rate cannot reasonably be established based on inflated, and unsustainable, deployment levels. Congress enacted section 276(b)(1) to "benefit the general public," not the payphone industry. Catering to PSPs' calls for protecting their industry from declining demand for their services directly undermines Congress's mandate to "promote competition" in that industry. Where there are payphones warranting a public subsidy to ensure availability "in locations where there would otherwise not be a payphone," Congress directed the Commission to "determine whether public interest payphones, which are provided in the interest of public health, safety, and welfare, ... should be maintained, and if so, ensure that such public interest payphones are supported fairly and equitably." 47 U.S.C. § 276(b)(2). Merely increasing the compensation rate to subsidize the payphone industry fails to meet that objective.

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[11] Id. at 13 & Table 5.

B. The payphone industry needs to face market reality.

As the NPRM acknowledges, "industry conditions have changed significantly." NPRM ¶ 18. The public's need and taste for payphones has declined, because new technologies and increased competition have brought consumers more choices.

Wireless services, in particular, have given the public an alternative to older telecommunications services, including payphone calling. Id. Competition and investment within the wireless industry have brought to consumers a wide range of affordable services and have earned the wireless industry a reputation for innovation and customer responsiveness. Since the *Third Report and Order* issued, the wireless industry has doubled its cumulative capital investment to $134 billion, and the number of wireless subscribers has more than doubled, to nearly 150 million.[12]

The *Third Report and Order* foresaw that wireless growth would require a significant reduction in payphones deployed. It explained, "the decreasing prices for cellular and PCS service," as well as "other factors," stand to "reduce the number of payphones" in service. *Third Report and Order* ¶ 141 n.282. "Such a reduction in the number of payphones" would be healthy – even necessary – as "the result of a competitive marketplace." Id. If state commissions "believe market forces are causing the removal of payphones in locations where they continue to be needed," then "state commissions should ... take action" to devise public interest payphone programs. Id.[13]

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[12] CTIA publishes wireless industry statistics semi-annually. June 2003 figures are available at *www.wow-com.com/pdf/MidYear_2003_survey.pdf*.

[13] At least a dozen states have implemented public interest payphone programs. If many other states have not, it may reflect the continued overdeployment of payphones, fostered by an already excessive compensation rate.

The Federal-State Joint Board on Universal Service reached the same conclusion. In its July 2002 *Recommended Decision* on adding new services to universal service support, it acknowledged the decline in payphone deployment since 1998 but concluded any increased payment directed broadly to most payphones would be a windfall to PSPs and not in the public interest.[14] Instead, the Joint Board recommended an inquiry into state-managed public interest payphone programs under section 276(b)(2) (id.), something the Commission has not yet seen a need to do.

Compared to the wireless industry, the payphone industry – sheltered from the full pressures of competition and consumer needs by a compensation system divorced from market signals -- has been largely stagnant. Indeed, the commenters agreed with Sprint that the payphone industry's decline is partly self-inflicted. Not only have many PSPs been slow to adapt to competition and market changes by redeploying or removing redundant payphones, but since deregulation of payphone rates they have also earned a reputation for poor service, poorly maintained equipment, and excessive rates for coin-based and 0+ calling. IDT at 10-13; WorldCom at 8, 11 & Att. 3; Sprint at 4. As for APCC's purported "concern for the most needy members of society," its members' "treatment of these consumers" (and their often "predatory pricing policies") contradict their self-serving public interest claims. IDT at 12-13. An industry article submitted by WorldCom argues that the "payphone business killed itself." WorldCom at 11 & Att. 2.[15]

[14] Federal-State Joint Board on Universal Service, *Recommended Decision*, CC Docket No. 96-45 (rel. July 10, 2002) at ¶ 50.

[15] It concludes, "[i]f [PSPs] had more respect for customers and actually took care of customers instead of abusing them, perhaps they'd still be a viable communications alternative, instead of the choice of last resort." Id. at Att. 2 p. 2.

Moreover, there is no real evidence to indicate that low-income communities are actually underserved by payphones.

Sprint does not doubt the NPRM's assumption (at ¶ 18) that payphone deployment has declined since 1999. Rather, Sprint believes that PSPs have failed to remove redundant phones in sufficient numbers to reflect declining demand. As a PSP itself, having experience with tens of thousands of its own payphones nationwide, Sprint has recognized the need to respond to marketplace reality. Sprint has responded by removing or redeploying redundant and underutilized payphones, to ensure the profitability of remaining phones. Often this has simply involved removing duplicate phones from banks of multiple payphones or from areas where too many phones are available for limited and declining market demand. Sprint continues to reassess payphone placement and market demand on an ongoing basis, as the key to the success of its payphone business.

C. Retaining the current methodology and increasing the compensation rate would ultimately undermine the payphone industry.

Sprint believes that the current payphone compensation policy has contributed to the payphone industry's decline. By exempting payphones from competitive market forces, current policy has discouraged innovation, improvements in service and rates, and the timely removal of uneconomic and redundant payphones. And as many commenters pointed out, increasing the payphone compensation rate would only "further deflate the demand for payphone calls" (Global Crossing at 6) and "accelerate the decline" of payphones (WorldCom at i) by discouraging the necessary rationalization of redundant, unneeded phones. ATX at 2; WorldCom at 5; AT&T at 10; Texas AG at 3-4; Sprint at 4-

5. By creating an environment of higher costs and surplus payphones that reduce revenues for other units that otherwise would be profitable, the policy would be ultimately damaging to the payphone industry.

Even with declining overall demand, payphones can be profitable. Certainly a great many payphones remain so. The petitions convey the false impression that most payphones are uneconomic, and indeed by focusing on a theoretical "marginal payphone," the Commission's current methodology encourages people to overlook the fact that most payphones continue to perform adequately. The Texas Attorney General explained that there are payphone owners managing to do well in today's market, just as Sprint is doing. This shows "that an increase in per call compensation is not justifiable." Texas AG at 1. The keys are monitoring the market, controlling costs, removing redundant phones, and deploying where there is sufficient market demand for a phone's service.

D. The "marginal payphone" methodology should be retired.

The NPRM tentatively concludes that the Commission should retain its old methodology, and asks whether doing so would be consistent with the Act's goals. NPRM ¶ 27. It also asks whether changing the methodology is warranted in light of changes in the payphone industry and marketplace. NRPM ¶ 28. Sprint believes that the "marginal payphone" methodology is inconsistent with the goals of the Act and should be retired. The decline in payphone traffic has made this all the more clear.

The methodology is based on a "bottom-up" estimation of the costs of a hypothetical "marginal payphone" -- one where the PSP "is able to review to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner." *Third Report and Order* ¶ 15 n.20. This hypothetical approach inevitably suffers from a variety of problems.

To begin with, the methodology is inherently circular. It is impossible to calculate a specific number of calls needed to cover cost without knowing the rate of per-call compensation. Instead, there are an unlimited number of combinations of price and quantity that, together, equal total cost. The selection of any one combination of price and quantity is arbitrary. It is also a difficult task, as the tortured appellate history of payphone compensation has made clear. The Petitioners would have the Commission reopen this review again and again.[16] And while the D.C. Circuit declined to strike down this approach as so unreasonable as to be unlawful,[17] the Commission must bear in mind the shortcomings of this circularity.

The NPRM acknowledges that this approach has created "regulatory distortion of the market" (NPRM ¶ 20), but raising the compensation rate (let alone doubling it) would make that distortion even more acute. The current methodology eliminates the market pricing signals that are essential to determining what payphones are needed, and at which locations. It also discourages PSPs from removing payphones at a rate sufficient to properly balance supply and demand, because it leads the payphone industry to expect that the Commission will periodically, and continually, increase the compensation rate. Thus, as demand for payphone services declines, the lack of realistic market signals will

[16] The RBOC Coalition said in its Petition that it expected to return for a further increase a year or two. RBOC Petition at 6.

[17] APCC v. FCC, 215 F.3d 51 (D.C. Cir. 2000). The court's opinion did not separately address the circularity of the methodology this issue, but found that the *Third Report and Order* was not so unreasonable or arbitrary as to be contrary to law.

lead to an ever lower usage profile for the "model" payphone, and thus to ever higher compensation rates.

Thus, the methodology ultimately will undermine demand for payphone services. By increasing costs with declining volumes, it will discourage consumers from utilizing payphones and will encourage a growing number of subscriber 8XX customers to block payphone-originated calls.[18] Sprint cannot quantify the price elasticity of payphone calling (NPRM ¶ 28), but clearly an increase in payphone calling costs – at a time when the costs of all other communications services are falling – can only suppress demand. The problem is made worse by the considerable administrative costs that a carrier-pays system imposes on IXCs.

The marginal payphone methodology does nothing to promote deployment where the public interest may warrant it. This methodology directs the greatest subsidy to higher-volume payphones that do not need it, and pays no regard to any public interest in having a particular payphone in place at any given location. The Petitioners presume that every payphone justifies a subsidy, so as to have widespread availability. That plainly is not what Congress intended or authorized.

The caller-pays approach, outlined in Section IV below, avoids all of these problems.

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[18] The Enterprise Networking Technology Users Association cautioned that ever increasing payphone costs will lead to "blocking toll-free calls from payphones if the rate is increased above what our companies can tolerate as an expense to do business." ENTUA Reply at 1 (noting also that the current methodology is "not an effective economic model"). The National Network to End Domestic Violence, however, added that not every subscriber 8XX customers has the luxury of blocking expensive payphone calls. NNEDV Reply at 7.

III. THE PETITIONERS' COST STUDIES AND THE COMMISSION'S INPUTS BOTH YIELD INFLATED RESULTS.

A. The Petitioners' cost studies are flawed and misleading.

The NPRM asks whether the methodologies used by the Petitioners in their cost studies are consistent with the *Third Report and Order.* NPRM ¶ 26. The comments submitted in response to the petitions have already shown that they are not. The Petitioners pretend to be following the Commission's methodology, but they have made material changes to generate a grossly inflated and illegitimate rate. ATX at 8; AT&T at 10-11; IDT at 14, Sprint at 2. The Texas Attorney General "take[s] issue with the methodology used by the petitioners to support their claims." Texas AG at 3.

1. The Petitioners' call volume data are unreliable.

The NPRM asks whether the Petitioners' claimed monthly call volumes of 233.9 and 219, respectively, are reliable. NPRM ¶ 28. They are not. APCC's average is "based on a survey that is fundamentally flawed" (AT&T at 11 & Decl. pp. 4-5) and "obviously biased" by selective reporting. Texas AG at 3.[19] See also ATX at 3. The RBOC Coalition's data are likewise "based on isolated samplings." ATX at 9. If in fact these PSPs have been willing to operate payphones with these volumes – less than half the volumes previously claimed by the BOCs -- there is no reason that they should be subsidized to maintain deployment at those levels.

Even more seriously, the Petitioners have also grossly manipulated the definition of a "marginal payphone." The *Third Report and Order* (¶ 139) includes two criteria:

[19] Given the evident unreliability of the Petitioners' submissions, the Texas AG (at 3) cautioned that the Commission should undertake "some type of independent statistical sampling of call volumes."

(1) that the payphone owner is "unable to make payments to the location owner," and (2) that "the payphone owner is able just to recoup its costs, including earning a normal rate of return." But the Petitioners cost studies redefined marginal payphones simply as those that pay no site commissions.[20] Removing that second criteria "improperly fails to exclude the unprofitable payphones" and therefore "does not accurately reflect call volumes associated with marginal payphones as contemplated by the *Third Report and Order*." AT&T at 13 & Bell Decl. p.12. The Commission's methodology was "not designed to make every payphone profitable," and "[p]ayphones with sufficiently low call volumes or sufficiently high costs will not be profitable, regardless of the compensation amount." *Third Report and Order* ¶ 79.

APCC also manipulated volume figures further by "utilizing only paid dial-around calls in determining the call volumes generated at a marginal phone," even though the Commission expressly held – and the D.C. Circuit affirmed -- that bad debt is "irrelevant" and adjusting for it creates "double-recovery." AT&T at 15 (emphasis in original). See *Third Report and Order* ¶ 162, affirmed by APCC v. FCC, 215 F.3d at 55-56. As AT&T pointed out, "APCC's improper efforts to inject its bad debt estimates into its volume analysis without any acknowledgement or explanation that 'bad debt' has been deemed irrelevant underscores the lack of credibility of APCC's entire methodology." AT&T at 15.

The RBOC Coalition's volume figures have other problems, too. For example, "it appears that the RBOCs used the daily revenues in the earlier commission analysis due to

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[20] The RBOC Coalition, however, also improperly includes in its estimates some payphones for which location rents are paid, after reducing the call volume for those "costs." AT&T at 16-17 n. 15.

internal practices to pay location rents based on payphone revenues, not just monthly call volumes," but "now proposes a recalculation using only call counts rather than daily revenues." ATX at 10-11. The RBOC Coalition's calculation is also based on just a single month, with no evidence that the selected sample is reliable. Id. at 11. As AT&T concluded (at 16), "Simply put, the Coalition cannot argue that the Commission should adhere to the 'marginal payphone approach adopted in the *Third Report and Order*, but then propose a methodology for determining 'marginal payphone calling volume that undermines the *Third Report and Order*."

2. The Petitioners' cost data are unreliable.

The NPRM asks whether the Petitioners' cost studies are accurately representing costs. NPRM ¶ 26. Again, they are not. The Petitioners padded an already outdated and inflated cost model for the theoretical "marginal payphone," even though "PSPs concede that per-payphone costs have decreased." Telstar at 1.

The Petitioners' cost studies add a self-serving estimate for "bad debt," again despite the *Third Report and Order*'s recognition – expressly upheld by the D.C. Circuit -- that "such estimates are ultimately unsupportable and do not predict reliably future bad debt." ATX at 15; see also AT&T at 17. Including an element for bad debt is also unlawful "because it would require some IXCs to pay the debts of other IXCs" (AT&T at 18), despite the Commission's and the D.C. Circuit's findings that section 276 prohibits "requir[ing] one company to bear another one's expenses."[21]

[21] *Fifth Order on Reconsideration and Order on Remand*, FCC 02-292 (rel. Oct. 23, 2002) (subsequent history omitted) ("*Fifth Order on Recon*") at ¶ 83, citing Illinois Pub. Telecomm. Ass'n v. FCC, 117 F.3d 555 (D.C. Cir. 1997), clarified on reh'g , 123 F.3d

The Petitioners also add a component for collection and litigation costs, which is similarly impermissible. The Commission previously explained "that the collection costs of dial around compensation are fairly represented by the SG&A portion of Joint and Common Costs." ATX at 13, citing *Third Report and Order* ¶ 178 and APCC v. FCC, 215 F.3d 51, 57 (D.C. Cir. 2000) ("[O]verhead presupposes that some details of costs will be submerged in the greater item of calculation."). The petitions also incorporate an inflated 11.25% interest rate, ignoring the Commission's adoption of IRS overpayment rates as the proper measure for "the time value of money." AT&T at 19-20, quoting *Fifth Order on Recon.* ¶ 100.

Further, the Petitioners' costs studies rely not on current costs, but on surrogate cost estimates dating from 1998, particularly costs of Davel Corporation. Yet Davel's public financial reports show that per-payphone costs have fallen drastically since the *Third Report and Order* and are no longer realistic. WorldCom at 15-16 & Att. 6. Capital costs have fallen, because equipment has been almost fully depreciated (AT&T at 20-21); equipment and contracting service costs are significantly lower (WorldCom at 15), and line charges are lower and may even drop further (RBOC Coalition at 8 n.23).[22] With the decline in payphone deployment, high-quality second-hand and refurbished equipment is more readily available. Several commenters also point out that PSPs have other revenue sources omitted from the Petitioners' purported cost studies.

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693 (D.C. Cir.1997), cert. denied sub nom. Virginia State Corp. Comm'n v. FCC, 523 U.S. 1046 (1998).

[22] State proceedings throughout the country have been reducing PSPs' line charges, as the RBOCs are compelled to implement the "New Services Test" as ordered in Wisconsin Pub. Serv. Comm'n, FCC No. 02-25 (rel. Mar. 2, 2000). Some states may also order refunds to PSPs for prior years.

These include increased coin revenues from today's higher rates (WorldCom at 12; IDT at 12) and revenues from advertising on payphone enclosures. Telstar at 5-6 & Att. A; WorldCom at 11-12 & Att. 4; IDT at 16. A growing number of payphones also offer data ports or Internet access services, often at premium rates, but the cost studies omit these revenues.

B. A "top-down" analysis shows no significant change in rate is warranted.

The impact of the Petitioners' manipulation of the data and methodology is dramatic. In the *Third Report and Order* (¶¶ 192-193), the Commission used a "top-down" analysis to check the reasonableness of its "bottom-up" default rate. As AT&T demonstrates, "[a]pplication of this same analysis here makes clear that Petitioners' proposals are grossly excessive and will result in windfall profits to payphone providers that must be borne by IXCs and their consumers." AT&T at 21. AT&T's analysis shows that a top/down approach yields a per call rate for coinless calls of $0.279 using average call volumes, and just $0.25 using marginal call volumes – little different from the current rate. Id. at 22-23.

C. The Commission's "inputs" overstate payphone costs.

The Notice asks whether the particular inputs adopted in the *Third Report and Order* for various cost categories continue to be appropriate or whether changed conditions warrant modifications. NPRM ¶ 29. If the overall methodology is not retired, Sprint believes the changed conditions of the payphone industry would warrant limited changes.

The Commission's previous allowance for depreciation is unrealistic, because it does not reflect the fact that the majority of payphones deployed today have already been depreciated fully. Depreciation expense is therefore overstated, and an allowance should be made to reflect this reality. Sprint also agrees with WorldCom[23] that, given the ready and growing supply of second-hand payphone equipment, capital costs are also overstated, and that an allowance should be made to reflect this reality. In addition, payphones have enjoyed significant reductions in their line costs, as a result of state implementation of the new services test.[24] Some payphone owners have even received refunds for prior years. An allowance for these benefits should be made as well.[25]

However, Sprint opposes the Petitioners' attempts to add allowances for collection costs, litigation costs, and bad debt. The *Third Report and Order* (¶ 162) rejected similar calls for an allowance for these costs, because they were not supported by an adequate record, and the Petitioners have not provided any more suitable record now. Regardless, these costs are part of a PSP's overhead, and providing a separate, additional allowance for any of them would be providing double recovery. The D.C. Circuit specifically upheld the *Third Report and Order*'s finding that additional allowances for these "costs" were not justified.[26]

[23] WorldCom at 16.

[24] See n.22, supra.

[25] IDT pointed out that average payphone volumes would be higher if fewer payphones were out of order. IDT suggested "adjust[ing] any methodology to include a 'nonworking payphone factor,'" so that poor maintenance practices are not rewarded by higher FCC-mandated compensation. IDT at 11-12. See also WorldCom at 14 & Att. 3.

[26] APCC v. FCC, 215 F.3d at 55-56.

The NPRM also asks whether revenues from additional services and activities should be added. NPRM ¶ 31. Certainly, the Petitioners' insistence on inflating costs while ignoring new and growing revenue opportunities shows their cost studies cannot be taken at face value. The impact of new revenue opportunities is substantial and growing, especially for the "marginal" payphone that the methodology ostensibly seeks to model.

Some payphones receive location subsidies in instances where deployment would otherwise be uneconomic. These can include subsidies from a building managers who needs a phone at its swimming pool or apartment lobby and business owners who find value in a payphone for their patrons. The methodology does not account for this practice, and the Commission should include an allowance for this or any public subsidies.

The methodology also ignores that payphone owners increasingly receive income from on-phone and enclosure advertising. WorldCom at 11; IDT at 16; Telstar at 5-6. The payphone industry's own publications highlight the growing value of these advertising opportunities,[27] yet the Petitioners ignored these revenues, too. The impact of advertising revenue may be enough to graduate many payphones from "marginal" status to higher levels of profitability. In addition, some payphones, particularly in high-traffic areas, are adding new ancillary services, such as Internet access and data ports. The impact of these services is unclear in the record, but their availability shows that the existing methodology is at best obsolete in focusing solely on traditional voice services. And these types of services would doubtless be more commonly available if PSPs were forced to compete more seriously for payphone users.

[27] Telstar at Att. A. See also WorldCom at Atts. 4-5.

IV. THE COMMISSION SHOULD ADOPT A "CALLER PAYS" SYSTEM.

The Notice acknowledges that the *Third Report and Order* noted that a caller-pays plan may "form[] the basis for the purest market-based approach." NPRM ¶ 32, quoting the *Third Report and Order* ¶ 115. The NPRM nevertheless tentatively declines to "adopt a 'caller-pays' methodology" on the mistaken assumption that Congress may disapprove of a caller-pays system. NPRM ¶ 32.

Sprint believes firmly that the Commission should seek a market-based solution that obviates the need for the current inefficient, contentious, and ultimately self-destructive payphone compensation regime. The Commission should not maintain a system that has served the industry and the public interest poorly, and which stands only to worsen as payphone volumes decline. Instead, the Commission should turn to a more rational and efficient system: allowing payphone owners to charge the *cost causer* for the payphone compensation.

A. A caller-pays system is the most rational and efficient per-call compensation approach.

The NPRM solicits comments on the costs versus benefits of a caller-pays system. NPRM ¶ 33. Throughout this proceeding, Sprint has advocated that any payphone compensation should be based on a market-based approach. The only true-market-based approach is a caller-pays plan, a system that allows the PSP, if it chooses, to assess a charge directly on the caller for the use of the payphone for an access code or subscriber 8XX call. Sprint has previously placed in the record an analysis by economists at Charles

River Associates that shows how and why a user-pays system provides the soundest economic basis for a payphone compensation regime.[28]

The caller-pays approach is rational and efficient, not least because – as with local calls – it links the price for the service to the calling party's choice of when, where, and whether to make a payphone call. The calling party determines whether the convenience of making a call at a payphone is worth the cost, or whether to make that call at another time and place. Moreover, for subscriber 8XX calls, the current carrier-pays system creates a disconnect between the party making the call and the party ultimately paying for the service (the 8XX subscriber). Payphone compensation is a rent for the usage of the phone. By putting that cost directly on the cost causer, a caller-pays approach avoids the inefficiencies inherent in spreading costs among other parties. Finally, a caller pays plan is administratively simple and efficient. Clearly costs are lower in a caller-pays system. It eliminates the administrative costs of tracking, reporting, and payments between hundreds of carriers and thousands of PSPs. It eliminates the costs of audits and certification, disputes and litigation, regulatory rate setting, and other complexities created by the current carrier-pays regime. It also eliminates the problem of payphone compensation fraud, by removing any incentive for autodialers and false payphone coding.[29]

[28] See Letter to Magalie Salas, Secretary, from Richard Juhnke, Sprint (Sept. 4, 1998), attaching Declaration of Stanley M. Been and R. Craig Romaine, Charles River Associates. For the Commission's convenience, a copy also was attached to Sprint's Opposition to the Petitions for Rulemaking in RM No. 10568 (filed October 23, 2002).

[29] The Ad Hoc Telecommunications Users Committee noted, for example, that one of its members "was charged dial-around compensation charges in excess of one million dollars that the member believes are fraudulent," and added, "an increase in the dial around rate will only exacerbate this problem." Ad Hoc Telecom Users Reply at 6.

The only benefit of a carrier-pays system is a measure of convenience to payphone users. However, as the NPRM recognizes, that convenience to the caller comes at a "high price to the consumer" (NPRM ¶ 33) – a price that can only increase, since IXCs must pass through the rising costs of payphone compensation to their customers.[30] To the extent any particular consumer may not have coins on hand to make a payphone call, many modern payphones accept credit card swipes, and more PSPs would add this capability to win additional consumer business.[31] Emergency and TRS calls remain free and coinless. Callers still have access to the carriers of their choice, even where the access call may involve a modest charge. 0+ calling also remains an option for consumers. Ultimately, Sprint believes the record will show that the costs of a carrier-pays regime exceed the benefit by a wide margin.

The NPRM asks whether circumstances have changed such that it is now appropriate to reconsider the caller pays methodology. NPRM ¶ 33. Sprint believes the acknowledged decline in public need for payphones requires reconsidering the Commission's approach to payphone compensation. If the payphone industry is to reach a realistic, sustainable deployment, it needs efficient pricing based on market signals, rather than a guaranteed recovery based on self-serving cost estimates of a surrogate, "marginal" payphone with a declining usage profile. Increasing the compensation rate,

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[30] In its December 2, 2003 comments, the International Prepaid Communications Association rightly explained that the impact on prepaid card customers is even greater, due to sizeable incentive and contract discounts that must be extended to wholesalers and retailers in the intensively competitive prepaid business. Comments of IPCA (filed Dec. 2, 2003) at 5.

[31] Some software modifications may be necessary to support a caller-pays plan, and the Commission should allow time for such transition. But there is no reason to think PSPs would not be able to adapt to a caller-pays system within a reasonable period of time.

particularly based on the flawed "marginal payphone" methodology, invites a vicious circle of higher rates that ultimately will contribute to the downward spiral of the payphone industry.

A number of parties have joined Sprint in supporting a caller pays plan. In the proceedings leading to the *Third Report and Order*, six IXCs endorsed the approach, either as a preferred position or as an acceptable alternative to the problems associated with attempting to fashion a cost-based rate. Paging companies also lent their support. Even some PSPs join Sprint and other parties in citing the many benefits of a caller-pays system. In comments filed in response the Commission's FNPRM following the D.C. Circuit's vacatur and remand of the *Second Order on Reconsideration*,[32] Bulletins – a major aggregator of independent PSPs – endorsed the caller-pays approach. Giving "the PSP the option of collecting coin at the payphone for the use of a subscriber 800 or toll free access number," it explained, avoids the many problems arising from the current carrier-pays rules and is "[b]y far the most superior compensation plan that is fair to PSPs." It continued,

> Bulletins PSPs generally prefer this superior compensation plan over one in which PSPs have the burden of billing and collecting the payphone surcharge from the carriers – who do not even take part in the usage of the payphone. Instead, under the caller-pays plan, the caller who places the toll free call at the payphone – often *not* the customer of the carrier involved with routing the call – pays for the usage of the payphone at the payphone.

Id. at 10.

[32] Reply Comments of Bulletins at 9-13 (filed July 3, 2003) in response to *Further Notice of Proposed Rulemaking*, FCC 03-119 (rel. May 28, 2003). The FNPRM followed the court ruling in Sprint v. FCC, 315 F.3d 369, 377 (D.C. Cir. 2003), vacating rules codified at 47 C.F.R. §§ 64.1399, 64.1310 (2001).

Sprint agrees with Bulletins that the caller-pays approach is the most efficient and sensible option available to the Commission.

B. A caller-pays approach is within the Commission's legal authority and not contrary to Congressional intent.

The NPRM seeks comment on the Commission's tentative conclusion not to adopt a caller-pays methodology. NPRM ¶ 32. The *Third Report and Order* recognized that a caller-pays system may "form[] the basis for the purest market-based approach," but it declined to adopt that approach on the assumption that Congress would disapprove. Nothing in section 276 requires per call compensation to be a carrier-pays plan, and nothing in it would deny the Commission authority to adopt a caller-pays alternative. Section 276 provides that

> [i]n order to promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public … the Commission shall take all actions necessary (including any reconsideration) to prescribe regulations that … establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every completed intrastate and interstate call using their payphone….

47 U.S.C. § 276(b)(1)(A). This provision merely requires the Commission to "establish a per-call compensation plan" that provides fair compensation to PSPs for all calls except emergency and telecommunications relay service calls. "The 1996 Act does not prescribe a particular method for achieving these goals," as the Commission has previously recognized. *Third Report and Order* ¶ 21. A caller-pays "plan" could consist simply of allowing payphone providers to choose whether and how much to charge calling parties for various types of calls, just as the Commission allows PSPs to choose whether and how much to charge calling parties for the local calls that make up perhaps

70% of total payphone-originated calls. If a market-based approach can be used to determine "fair" compensation from end users for local calls, then a plan that leaves it to market forces to determine whether and how much PSPs collect from end users for other types of calls is sufficient to meet the duty imposed on the Commission by section 276(b)(1)(A).

The NPRM asks whether section 226(e) "permits us to conclude that we need not prescribe compensation apart from advance payment by [the] consumer." NPRM ¶ 33, citing 47 U.S.C. § 226(e). Sprint believes the answer is clearly yes.

Section 226(e) does not bar a caller-pays plan. That provision directs the Commission to "consider the need to prescribe compensation (other than advance payment by consumers) for owners of competitive public pay telephones for calls routed to providers of operator services." 47 U.S.C. § 226(e)(2). That language is hardly a bar to Commission reliance on such advance payment as a means of fair compensation. In its initial NPRM implementing that provision, the Commission observed that if it declined to prescribe compensation, as was with in its discretion under that provision, payphone owners would be free to charge the calling party for the use of their payphones.[33] By adopting a market-based caller-pays plan, the Commission would not be "prescrib[ing] compensation," and section 226(e)(2) would not even be implicated.

Moreover, section 276 plainly superseded the compensation provisions of section 226(e). Whatever the intent of Congress in 1990, when section 226 was adopted, Congress did not display any such intent in 1996 when it passed section 276 setting an

[33] Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, 6 FCC Rcd 1448, 1450 (1991) (subsequent history omitted).

entirely new foundation for payphone compensation. In creating section 276, Congress could have stated a desire that a per-call plan must be limited to carrier pays, but it did not.

Section 226(e) also must be understood in the context of its time. Then, "the compensation provision of section 226 was direct[ed] solely at the independent PSPs," because the vast majority of payphones were LEC-owned and recovered compensation through the carrier common line charge – a subsidy mechanism removed by section 276. *Third Report and Order* ¶ 20 n.33. In fact, the main reasons offered in the Senate Report[34] for section 226(e) are entirely inapplicable to the post-section 276 world. It pointed to the need to protect independent PSPs from unfair competition by LEC phones, which were then still subsidized by other LEC operations. Today, however, LEC payphones are no longer subsidized but rather are on an equal footing with phones of independent PSPs. The Senate Report also expressed concern that caller-paid compensation would conflict with the states' authority to set rates for payphone calls. But the Commission has since expressly preempted any state rate setting in the *First Report and Order.*[35] The Senate Report also pointed to the potential inconvenience to consumers of needing coins to make access code calls. Although this remains the case, coin-callers face the same inconvenience every day, and there are ways PSPs can mitigate the inconvenience, as discussed above.

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[34] S. Rep. 101-439, 101st Cong., 2d Sess. at 20 (1990) (Senate Committee on Commerce, Science, and Transportation Report on the Telephone Operator Consumer Services Improvement Act).

[35] Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, *Report and Order*, 11 FCC Rcd 20541 (1996) (subsequent history omitted) ("*First Report and Order*").

Congress has given the Commission broad authority to fulfill the mandates of section 276(b)(1)(A). The caller-pays approach is within that authority.

V. CONCLUSION

The Commission's current payphone compensation regime works poorly and does not serve the public interest. The Commission should consider a new policy approach. It should revisit the legality, efficiency, and societal benefits of a market-based, caller-pays alternative, together with a targeted public interest payphone program under Section 276(b)(2).

Respectfully submitted,

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January 7, 2004

CERTIFICATE OF SERVICE

I hereby certify that the copy of the foregoing Comments of Sprint Corporation in WC Docket No. 03-225 and RM No. 10568 was sent by electronic mail or first class mail on this 7th day of January, 2004, as noted below.

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